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SUBJECT: EU FINANCIAL REGULATORY REFORM: CHIEF REGULATOR HAS
CONCERNS ABOUT THE LOSS OF NATIONAL AUTHORITY

REF: A)BRUSSELS 0290
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¶1. (SBU) Summary: A recent conversation between Consulate
Representatives and Joachim Sanio, the President of the German
Federal Financial Supervisory Authority (BaFin), revealed concerns
over strong French influence in the new EU financial regulatory
agencies currently being created. Sanio commented on the short
window of opportunity for EU regulatory reform, which explained the
pace and legal means by which the EU Commission acted. Sanio also
believes that the EU Commission will gain power over financial
regulation at the expense of national regulators. END SUMMARY.

Background: Overview of EU Financial Regulatory Reforms

¶2. (U) In February 2009, a high-level group chaired by the former
Banque de France Governor Jacques de Larosiere drafted a series of
proposals to strengthen the EU financial regulatory system in
response to a request from EU Commission President Barroso. The de
Larosiere Report became the foundation of a series of reforms
undertaken by the EU. By May, a "Communication" was adopted, with
draft legislation proposed on September 23, and further defining
legislation written by October 26. The EU Council and Parliament
currently are considering these proposals.

¶3. (U) Under the new legislation, a European Systemic Risk Board
(ESRB) will be established to detect risks in the financial system
as a whole. In addition, a European System of Financial Supervisors
(ESFS) composed of national supervisors will encourage cross-border
practices in financial supervision.

¶4. (U) The ESFS will consist of three new "European Supervisory
Authorities" that will replace the existing "Level 3 committees."
Like the current Level 3 committees, they will cover the following
areas: 1)banking ("the European Banking Authority" (EBA) replacing
CEBS), 2)securities ("the European Securities and Markets Authority"
(ESMA) replacing CESR); and 3)insurance and occupational pensions
("the European Insurance and Occupational Pensions Authority"
(EIOPA) replacing CEIOPS). The objective of these "Authorities" is
to: 1)coordinate the work of national supervisors; 2)arbitrate in
the case of cross-border disagreements; 3)harmonize national
regulatory rules; and 4)directly supervise certain pan-European
institutions which are regulated at the EU level, such as Credit
Rating Agencies.

Remarkable Speed Results in "A Legal Coup d'etat"

¶5. (SBU) The financial crisis, according to Sanio, has opened a unique window of opportunity for the EU financial reforms. Sanio believes that the speed has been driven by French interests, which were at the heart of the original proposal. There is also a uniquely pro-European constellation in favor of reforms in the EU Commission and the British government. (Sanio believes this window will close in May 2010, the latest date that Gordon Brown has to call a new election.)

¶6. (SBU) The remarkable pace with which the EU Commission has pushed through the reforms, amounts in Sanio's opinion to a legal "coup d'etat." In order to put the new regime in place as soon as possible, Sanio posited, the Commission drafted it as "regulations" instead of as "directives," since regulations have a more general scope and do not require each nation to pass implementing legislation. Sanio considers this move "a form of procedural abuse" which circumvents national legislatures. He also thinks that without this "unprecedented legislative maneuver" the EU would not have been able to accomplish the reforms prior to the UK election and a "unique opportunity" for the Commission would have been lost.

Sanio Questions the Legal Authority of the New Agencies

¶7. (SBU) For Sanio, the new EU regulatory architecture raises a number of legal points. Sanio pointed out that in the Meroni Case (1958), the European Court of Justice (ECJ) set out a number of rules and conditions that have to be met before an EU institution can delegate its powers to bodies not mentioned in EU Treaties. The Court ruled that a treaty body can only delegate clearly defined, i.e. non-discretionary powers, and must remain able to review the

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exercise of these powers.

¶8. (SBU) Based on the Meroni ruling, Sanio believes that the new "European Supervisory Authorities" (ESAs) can only be sub-organizations ("secondary institutions") of the Commission with powers delegated to them by the Commission. "It's very clearly a power game," said Sanio. "What the Commission de facto does is to reel in for itself the entire financial supervision. It will fully dominate European financial supervision, since all decisions will in the end have to be approved by the Commission."

Power Lost by the National Authorities

¶9. (SBU) Sanio believes that as the EU Commission gains power over financial regulation and supervision, the national regulators will lose it. The EU Commission "will have its foot in the door," and regardless of the amount of power maintained by national institutions, the EU Commission will always "remain a player at the table."

¶10. (SBU) Sanio also views the EU Commission's offer to pay for the new regulatory bodies with skepticism. Several Eastern European members have welcomed this offer, particularly Poland and Lithuania, according to Sanio, who currently find it difficult to pay their share. Sanio and his organization, BaFin, by contrast would like to increase the direct payment by States to these agencies, because under EU law, that would strengthen the power of the national regulators. "We even somewhat in jest proposed at one point to pay the Polish share if they would give us their 27 votes in return." However, Sanio thinks that Germany will not be able to sustain its position.

Winners and Losers of EU Regulatory Reform

¶11. (SBU) Key beneficiaries of the reforms, Sanio said, will be the French, who have been the core advocates and the motor driving the reforms. The specific interest of the French, apart from

strengthening their overall influence over EU regulation through the Commission, is to establish the European Securities and Markets Authority (ESMA) in Paris. This would significantly strengthen Paris as a financial center at the expense of London and Frankfurt. While Frankfurt hosts the European Central Bank (ECB) and will likely continue to house the newly-formed EIOPA (currently CEIOPS), Sanio believes that hosting the supervisory agency for capital markets and securities will give Paris more influence. "The ECB might be more powerful and more prestigious, but in terms of economic value and political influence on financial market developments, ESMA clearly is the better prize." said Sanio.

¶12. (SBU) The British, by contrast, are the ones that have the most to lose, according to Sanio. While for Germany financial supervision is an "abstract issue," for the UK, strong European financial supervision with operative powers over securities in French hands, poses an "incalculable risk" and a serious economic threat. Currently, the financial center London, Sanio stated, is "underregulated." With its manufacturing sector being "practically dead," Britain is economically dependent on maintaining the competitive advantage of its financial sector through "light touch regulation."

¶13. (SBU) Comment: Sanio's comments regarding the French influence on the new EU Financial Regulatory architecture appear consistent with general sentiment in Germany. The October 30 announcement by France that it would like Michel Barnier, French Minister for Agriculture and Fisheries, to become the "Internal Market and Services Commissioner" (replacing McCreevy from Ireland) has reinforced this German view. In that position, Barnier would oversee EU banking legislation and be able to influence the shape of the new EU regulatory instruments.

¶14. (U) This cable has been coordinated with Consulate Duesseldorf and Embassy Berlin.

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